Fiscal Policy and the Current Account

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Discussion by
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A very topical question:

→ for policy: G20 "Framework" on CA and fiscal imbalances

→ academic debate on Twin Deficits

Different ways to answer the question

→ Use (multi country DSGE) model such as GIMF

→ Conduct empirical exercise with (panel) data

Range of estimates is wide

→ Uncertainty (conf interval, econometric technique, sample, etc)

→ What the answer depends on:

- Initial conditions (O-gap, U-rate, debt level, etc)
- Policy decisions: composition of package, other policy

- Very topical! (but: crowded field)
- Very well written! Clear results/intuition
- Well rooted in literature (nice Appendix I)
- Plausible results (no surprise?)
- Encompassing: large dataset, different aspects of the issue analyzed
- Strong efforts in the econometric estimation
- The drawback: many results to comment
  → Solutions: show "preferred" estimation? Focus on key parameters? take country examples?
- Other (apparently contradictory!) comment: other factors may play a role

- Authors control for:

  - country sample, trade openness, ER regime, interaction regime and financial openness, output gap, public debt, share of revenue, fiscal expansions vs contractions; large changes
  - panel (FE) regressions, event case, VAR

- Question on specification (slope homogeneity): why not add dummy variables also in level

$$Y_{it} = a_0 + a_1 X_{it} + etc$$
$$Y_{it} = a_0 + a_1 X_{it} + a_2 D_i + a_3 D_i X_{it} + etc$$

- how was the threshold for public debt determined?

- plausible results (intuitive)

- how about further interactions? (if they are true simultaneously). Why not add output gap in all regressions?

- lagged dependent variable?

Discussion of endogeneity:

• Panel regressions and VAR (A and Q frequency): why show all?

• Especially given discussion on CAPB p.7

• Intuition why controling for endogeneity leads to stronger results (see Bluedorn and Leigh paper!)

Discussion of large changes / asymmetries:

• why not use panel regressions and move to event case analysis?

• could interact CAPB with dummy variable for large or small, consolidation or expansion

Other factors may affect the Twin Deficit relation:

- Composition of the package (tax vs spending)
- What tax? What type of spending?
- Transitory or permanent, expected or not
- Reaction of the monetary authority?
- Change over time?
- Other countries? Coordination?
- Are variables defined as deviations from cross-country average? Time dummies?
- Illustrations with GIMF…

Effect of Alternative Fiscal Scenarios on Current Accounts ("Twin Deficit" Ratio)
The table shows numbers for the change in the current account (% of GDP)
Note: simulations realized with immediate monetary reaction

	US	Europe
Government consumption	0.53	0.28
Government investment	0.43	0.24
General transfers	0.08	0.05
Targeted transfers	0.27	0.17
Labor tax rates	0.13	0.09
Consumption tax rates	0.12	0.13
Capital tax rates	0.13	0.11

- A very useful exercise

- A pleasure to read

- Comforting results

- Maybe a bit dense: narrow down to key effects of interest

- Choose a preferred methodology, rest as robustness?

- Further work: explore other sources of variation in the Twin Deficit relation